

Internal Revenue Service
Appeals Office

Department of the Treasury

Employer Identification Number:

Release Number: **201720010**

Release Date: 5/19/2017

Date: February 22, 2017

UIL Code: 501.00-00

501.36-00

Person to Contact:

Employee ID Number:

Tel:

Fax:

Certified Mail

Dear

This is a final adverse determination that you do not qualify for exemption from Federal income tax under Internal Revenue Code (the "Code") section 501(a) as an organization described in Code section 501(c)(3).

The adverse determination was made for the following reason(s):

You are not operated exclusively for one or more purposes specified in § 501(c)(3) of the Internal Revenue Code. A substantial activity of yours is the providing, licensing, and support of a software program, for a fee, to unrelated organizations that are not tax exempt.

Contributions to your organization are not deductible under section 170 of the Code.

You are required to file Federal income tax returns on Form 1120. File your return with the appropriate Internal Revenue Service Center per the instructions of the return. For further instructions, forms, and information please visit www.irs.gov.

We will make this letter and the proposed adverse determination letter available for public inspection under Code section 6110 after deleting certain identifying information. We have provided to you, in a separate mailing, Notice 437, *Notice of Intention to Disclose*. Please review the Notice 437 and the documents attached that show our proposed deletions. If you disagree with our proposed deletions, follow the instructions in Notice 437.

If you decide to contest this determination, you may file an action for declaratory judgment under the provisions of section 7428 of the Code in one of the following three venues: 1) United States Tax Court, 2) the United States Court of Federal Claims, or 3) the United States District Court for the District of Columbia. A petition or complaint in one of these three courts must be filed within 90 days from the date this determination letter was mailed to you. Please contact the clerk of the appropriate court for rules and the appropriate forms for filing petitions for declaratory judgment by referring to the enclosed Publication 892. You may write to the courts at the following addresses:

United States Tax Court
400 Second Street, NW
Washington, DC 20217

US Court of Federal Claims
717 Madison Place, NW

Washington, DC 20005

U. S. District Court for the District of Columbia
333 Constitution Ave., N.W.
Washington, DC 20001

Processing of income tax returns and assessments of any taxes due will not be delayed should a petition for declaratory judgment be filed under section 7428 of the Code.

You also have the right to contact the office of the Taxpayer Advocate. Taxpayer Advocate assistance is not a substitute for established IRS procedures, such as the formal appeals process. The Taxpayer Advocate cannot reverse a legally correct tax determination, or extend the time fixed by law that you have to file a petition in a United States Court. The Taxpayer Advocate can, however, see that a tax matter that may not have been resolved through normal channels get prompt and proper handling. If you want Taxpayer Advocate assistance, please contact the Taxpayer Advocate for the IRS office that issued this letter. You may call toll-free, 1-877-777-4778, for the Taxpayer Advocate or visit www.irs.gov/advocate for more information.

If you have any questions, please contact the person whose name and telephone number are shown in the heading of this letter.

Sincerely Yours,

Appeals Team Manager

Enclosure: Publication 892



**Department of the Treasury
Internal Revenue Service**

P.O. Box 2508
Cincinnati, OH 45201

Date: May 12, 2016

Employer ID number:

Contact person/ID number:

Contact telephone number:

Contact fax number:

Legend:

M = Name
O = Organization
P = Platform Name
Q = State

R = Date
S = Date
T = Date
U = Date

w dollars = dollar amount
x dollars = dollar amount

Dear _____

We considered your application for recognition of exemption from federal income tax under Section 501(a) of the Internal Revenue Code (the Code). Based on the information provided, we determined that you don't qualify for exemption under Section 501(c)(3) of the Code. This letter explains the basis for our conclusion. Please keep it for your records.

Issues

Do you qualify for exemption under Section 501(c)(3) of the Code? No, for the reasons stated below.

Facts

You were formed by Articles of Incorporation on R in the state of Q. Your Articles state you aim to strengthen communities that are ill-served by existing media, specifically by broadening the informed electorate by publishing original journalism that provides civic education for the less-than-affluent public. Your Articles further state you will publish the journalism on the internet through software that builds community cohesion by encouraging and enabling civic networking.

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You amended your Articles of Incorporation on T to state that your purpose is to strengthen communities that are ill-served by existing media, through, but not limited to, developing licensing, and distributing publishing software to local news co-ops that enables co-ops to broaden the informed electorate by publishing original journalism that provides civic education for the less-than-affluent public and to building community cohesion by encouraging and enabling civic networking. The amendment also states you may provide licensed co-ops with IT support, training, and other services associated with launching and running a successful local news co-op.

You then amended your Articles of Incorporation on U. This most recent amendment changed your name and indicates your purpose is to provide mentorship and educational and administrative support to independent journalism initiatives across the United States in order to serve the growing number of communities that lack the robust sources of information on which people need to make sound citizenship decisions, including in particular to focus on initiatives that seek to (1) educate citizens in these underserved communities regarding current events of significance and the workings of government and other civic institutions, and (2) strengthen the civic life of these underserved communities.

You previously applied for exemption under Section 501(c)(3) of the Code and your application was denied. Your primary activity was the provision of publishing open source software for community internet news sites. Most community web based news sites were limited in their early stages by the software available to them. You believed you could make an important contribution by developing sophisticated open source software that could be provided to community sites to improve their effectiveness. But several technology companies rolled out improved display software, meeting the most immediate needs, especially by open source software called M that was developed by the O and you realized you needed to explore other ideas. Just as important, it has become clear to you that even with better publishing software most community online news organizations are struggling and will need broad support if they are to thrive.

You submitted a new Form 1023 on S. Your Form 1023 and your bylaws now indicate your mission is to provide mentorship and educational and administrative support to independent journalism initiatives across the United States to serve the growing number of communities that lack the robust sources of information that people need to make sound citizenship decisions. Your main focus is on civic learning initiatives that seek to (1) educate citizens in these communities regarding current events of significance and the workings of government and other civic institutions, and (2) strengthen the civic life of these underserved communities.

To accomplish your mission, you have developed a news co-op model for community level internet journalism and news. You wrote there has been a significant collapse of print newspapers which threatens the civic engagement that is crucial to democracy. Many Americans especially those less affluent stopped reading newspapers available on the internet because they did not focus on their interests and needs; they lost access to most reporting about civic matters in their communities. The on line news co-op model you have developed is to be used by community groups. This model is easily replicable from community to community, the way food co-ops and credit unions replicated from coast to coast. Their revenue structure is designed to make them thrive even as newspapers fade.

You have developed educational materials including a comprehensive guide for creating news co-ops, templates for business planning, and plans for enrolling founding members, all supported by your staff's guidance. Ongoing staff support will include problem solving and online forums.

You will work with community groups or affiliates who:

- Commit to journalism criteria that are consistent with your mission.
- Have strong community support and be able to build increased engagement with additional readers.
- Are strong and committed as well as are focused on civic learning and currently produce or plan to produce reliable on line news.

You will provide to your affiliates the following:

- Mentorship approaches that could thrive in the digital era.
- Training on best practices in Internet journalism.
- Administrative and program support to minimize the time they need to spend on tasks such as bookkeeping, tracking membership and information technology, and therefore to ensure maximum staff time for news coverage and civic engagement. This will also result in lightening the load of the Affiliates, strengthen their journalism and improve reader involvement and engagement.

The administrative support component you are providing to the affiliates is through a software platform (the "P Platform") composed of M, plus off-the-shelf database software, plus a modest set of digital tools that you are developing to strengthen the impact of civic education that on line news initiatives can offer,

You are assembling the P Platform as an M add-on because it is not available either on the market or from open source developers. M is publicly licensed under a widely used free software license that guarantees end users the freedom to copy and modify it. The digital tools you are developing to complete the P Platform will be similarly licensed. The tools will be uploaded to the same free software repository as M so that your affiliates and the general public can use them. The P Platform will be made freely available to the public so no copyright will be claimed and no copyright notice will appear. You will not issue software licenses. Rather, you will make the P Platform software available to Affiliates and to the public under a public license so that the software can be freely used, distributed, and modified.

Your software will enable web based news sites to:

- a) Invite readers to collaborate with editors in the news-gathering process, to engage with other readers in pursuit of civic goals, and to become members of the news sites,
- b) Provide automated bookkeeping and membership tracking so that news sites can put maximum effort into covering their community's news and be less burdened by administration.

The program support that you will offer to affiliates is primarily journalism education and mentorship in offering civic education to affiliates' own readers. Furthermore, you will provide support for affiliates in using the P Platform. As soon as you secure adequate foundation funding, an anticipated 25% - 30% of your staff time and resources will be devoted to:

- (i) The provision of education, training, and technical support to affiliates on how to use the P Platform; and
- (ii) Maintenance of the P Platform.

In addition, you will add educational materials and an online forum to your website where the public can ask questions about the P Platform and have their questions answered by your technical experts. As part of the forum, users will also be invited to exchange ideas and best practices. Your staff will monitor the discussion

sites in search of topics that your staff could subsequently address in the form of educational webinars and other educational services to affiliates.

Your software will eventually provide the news affiliates/news co-ops with:

- An upgrade to the readership database, with automated functions that sign up new members and renew memberships.
- Tools that create reports on readership analysis, delivering trends for each affiliate as well as a comparison against the full universe of affiliates.

You submitted a sample Affiliate Agreement. This agreement includes the terms that the affiliate must comply with at all times, such as reliable news, relevant journalism, etc. The agreement also describes the services and materials you will provide. These services, in part, include, a "how to" manual, mentoring on best journalism practices, a preliminary website and membership database, training for staff, website hosting and IT support, for a w dollar up-front fee.

During the 12 month period after an affiliate is formed and is able to launch news coverage, you will provide additional services and materials consisting of :

- i) Life-issue reporting items that the affiliate can publish or adapt (or omit), as the affiliate's editor sees fit, at no charge.
- ii) Website upgrade plus training so that the affiliate can present news in a distinctive environment that invites civic engagement and editorial collaboration, at no charge
- iii) Continuing iterations to improve the website's effectiveness, at no charge.
- iv) Any upgrades or improvements of P at no charge.
- v) Tools that create reports on readership, membership and business analysis, delivering trends for the affiliate as well as a comparison against the full universe of affiliated sites, at no charge.
- vi) Resources and training to help affiliates conduct trainings, at no charge.
- vii) Optional on-site consulting, at your then-current consulting fee plus travel expenses.

During Launch Stage Year 2 and subsequent years ("Operational Stage") you will continue to provide affiliates all Organization and Launch Stage services and materials in exchange for the affiliate's payment of a fee of % of gross revenues to partly offset your costs of services, travel, and related administration.

Each affiliate will provide you a report each year, on an agreed-upon date, summarizing its gross revenues so that the parties may agree upon the fee. Further, each affiliate will make timely payments to you of (a) the w dollars upfront fee for hosting of affiliate's preliminary Website and IT support; (b) fees and reimbursements, if any, for optional on-site consulting and related travel; and (c) the fee of % of gross revenues.

You have set a maximum annual fee of x dollars. You are able to offer these services to affiliates at much lower costs because you have received and continue to seek foundation funding, and because your founders have worked without compensation for many years. You also stated that your Program Support services are not currently commercially available anywhere; but if a monetary value were to be placed on them, it would be unaffordable for an affiliate. The value would far exceed the amount of any fee or revenue-sharing arrangement that could conceivably be agreed on between you and an affiliate.

You promote your organization through your website which states your mission is to

. It further states that

You have an independent volunteer board of directors. You will be funded by fees as well as gifts, grants and contributions.

Law

Section 501(c)(3) of the Code exempts from federal income tax corporations organized and operated exclusively for charitable and educational purposes, among others, no part of the net earnings of which inures to the benefit of any private shareholder or individual, and no substantial part of the activities of which is carrying on propaganda, or otherwise attempting, to influence legislation, and which does not participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of (or in opposition to) any candidate for public office.

Treas. Reg. Section 1.501(c)(3)-1(a)(1) provides that in order to be exempt as an organization described in Section 501(c)(3) of the Code, an organization must be both organized and operated exclusively for one or more of the purposes specified in Section 501(c)(3). If an organization fails to meet either the organizational test or the operational test, it is not exempt.

Treas. Reg. Section 1.501(c)(3)-1(c)(1) provides an organization will not be regarded as a Section 501(c)(3) exempt organization if more than an insubstantial part of its activities is not in furtherance of an exempt purpose.

Treas. Reg. Section 1.501(c)(3)-1 (d)(1) (ii) provides an organization is not organized or operated exclusively for exempt purposes unless it serves a public rather than a private interest.

Rev. Rul. 72-369, 1972-2 C.B. 245, provides an organization formed to provide managerial and consulting services at cost to unrelated exempt organizations does not qualify for exemption. It states an organization is not exempt merely because its operations are not conducted for the purpose of producing a profit. To satisfy the "operational test" the organization's resources must be devoted to purposes that qualify as exclusively charitable within the meaning of Section 501(c)(3) of the Code and the applicable regulations. Providing managerial and consulting services on a regular basis for a fee is trade or business ordinarily carried on for profit. The ruling holds that furnishing the services at cost lacks the donative element necessary to establish this activity as charitable.

In Better Business Bureau of Washington, D.C., Inc. v. United States, 326 U.S. 279 (1945), the Supreme Court held that the presence of a single non-exempt purpose, if substantial in nature, will destroy a claim for exemption regardless of the number or importance of truly exempt purpose.

In Forest Press Inc. v. Commissioner, 22 T.C. 265 (1954), the Tax Court determined that an organization "devoted to developing and propagating the use of the Dewey Decimal Classification System and Related Index" was a charitable organization. Forest Press' primary activity was the ongoing development of the system, which required continuous revision. To this end, Forest Press regularly employed an editor-in-chief and four editorial assistants and an additional two to three editorial assistants as publication dates approached. By the time Forest Press was formed, the System had "been adopted by more than 90 percent of the libraries in the

United States to classify and index their collections" and was "in use in 42 countries." Thus, the court concluded that the System was "an important aid to education and research and not a commercial enterprise.

In B.S.W. Group, Inc. v. Commissioner, 70 T.C. 352 (1978), the Tax Court held that an organization did not qualify for exemption under Section 501(c)(3) of the Code because it was primarily engaged in an activity that was characteristic of a trade or business and ordinarily carried on by for-profit commercial businesses.

In Easter House v. U.S., 12 Cl. Ct. 476 (1987), the organization, in exchange for a fee, provided adoption services to parents seeking to adopt a child, including services to pregnant women who intended to place their newborns for adoption. These fees were the organization's sole source of income. The Claims Court concluded that the organization's business purpose of operating an adoption service, not the advancement of educational and charitable activities, was its primary goal. It competed with other commercial organizations providing similar services. Thus, "[p]laintiff's competition provides its activities with a commercial hue." 12 Cl. Ct. at 486. Accordingly, the organization did not qualify for exemption under Section 501(c)(3) of the Code.

Application of law

You are not as described in section 501(c)(3) of the Code because you have not established that you meet the operational test as per Treas. Reg. Section 1.501(c)(3)-1(a)(1).

You have not shown as required by Treas. Reg. Section 1.501(c)(3)-1(c)(1) that you are primarily engaged in activities which accomplish one or more of such exempt purposes specified in section 501(c)(3) of the Code. For example, you are providing open source software in the form of the P platform to community groups who operate as co-ops to produce on line news sites. In addition you are providing consulting and technical services to the community groups to help them organize as independent news co-ops to establish on line news sites for a startup fee and ongoing technical support services for % of their gross revenue. . Your activities are best described as providing a product with product information and are analogous to a product manual. This indicates you are operating for substantial nonexempt purposes which precludes you from exemption under Section 501(c)(3).

You are not operated exclusively for exempt purposes because you serve private rather than public interests as required by Treas. Reg. Section 1.501(c)(3)-1 (d)(1)(ii). Your software applications are tailored to community groups organized as new co-ops which you help establish. You have no operational control over these co-ops who will operate independent on-line news sights. This indicates you are operating for their private interests which precludes you from exemption under Section 501(c)(3).

You are similar to the organization described in Rev. Rul. 72-369. You are providing technical services as well as training on the use of the P Platform for an upfront fee of w dollars and an annual fee of % of their gross revenue. Like the organization in the revenue ruling, you are providing services on a regular basis for a fee in a manner similar to a trade or business. Moreover, your services for a fee are focused on community groups organized as news co-ops unlike the organization in the revenue ruling that focused on unrelated tax exempt organizations.

Your activities are not like those of the organization in Forest Press Inc. v. Commissioner, 22 T.C. 265 (1954). In Forest Press, the organization's primary activity was the continued development and propagation of the Dewey Decimal Classification System, which the Tax Court described as "an important aid to education and research," and which classification system was adopted by more than 90% of the libraries in the United States and in 42 foreign countries. You argue that your programs will assist communities without access to

newspapers form news co-ops to operate on line news sites. You will charge fees to the groups. By providing this type of software tailored to each news co-op's needs, your activities are neither educational nor comparable to promoting the Dewey Decimal Classification System. Furthermore, you do not limit distribution of your programs. Your only control over the news co-op is a check to assure it upholds your values that the journalism published is relevant to the less-than-affluent readership. The programs are also available to all organizations, commercial or otherwise. Thus, your activities are neither educational nor advance education within the meaning of I.R.C. Section 501(c)(3).

You are similar to the organizations described in B.S.W. Group, Inc. v. Commissioner and Easter House v. U.S. As a substantial activity, you are developing and distributing software to community groups you help establish as news co-ops which are not exempt organizations. In addition, the news co-ops will pay for the software and its support through annual fees. Your activities compete with other commercial publishing software developers and distributors. Such competition provides your activities with a commercial hue. More than an insubstantial part of your activities are not in furtherance of charitable or educational purposes, or other exempt purposes which precludes you from exemption under Section 501(c)(3).

Your position

You said you would like to note that your primary activity as described in the original application that was denied was "development of sophisticated publishing software that offers a welcoming civic networking space for its users and allows the news to be covered from the readers up rather than from institutions down." In a subsequent response to questions raised by the Service at that time, your activity was broadened to "the development, licensing, and distribution of software designed not only to publish licensed co-ops' news on the Internet but also to help them best serve their communities by maximizing financial strength and staff time that can be devoted to reporting rather than record-keeping and other routine duties that can be automated." You said in your present more informed view, these activities were appropriately rejected by the Service.

Since that time, and well before your submission of your current application, the software development, licensing, and distribution effort has been pursued solely for the purpose of enabling your current primary activities as described previously: educating and training Affiliates on how to use the platform, providing technical support to Affiliates that are using the platform, and maintaining the platform for use by Affiliates. Accordingly, you agreed that if you were granted exemption, the effective date would be the date of your new application submission. You agreed that you did not qualify for exemption prior to the application date.

Finally, you stated that your activities further an educational purpose by:

- Developing educational materials on best practices and ethics in journalism and civic learning; providing these materials to community groups that plan to produce news; mentoring these groups, one-on-one, to help them develop confidence and expertise; and offering regular updates in a rapidly changing journalism environment.
- Providing community groups with comprehensive guidance for creating a news organization, including:
 - analyses of readership and revenue potential in new communities
 - development of membership enrollment plans
 - an enrollment education webinar
 - model financial plans with spreadsheet templates and matching charts of accounts, and assistance in tailoring these to specific communities

- Offering mediated online discussion sites for community groups' editors and executive directors to help them learn from one another, form alliances, identify common challenges, and work together to meet the challenges. Your staff will monitor the discussion sites and keep a constant lookout for new topics that can be addressed using educational webinars and other educational services to the groups.
- Offering community groups with the expertise of individuals. You plan eventually to make this expertise available via videos.

To clarify your activities, you indicated that the fact that publishing tools were created in large part from publicly available and free open source software is not relevant to your activities. You use the software simply as a tool to enable your educational mission. You have no interest in developing or licensing any software or using any software to create or sell products.

You also said your board members will not benefit financially in any way.

Our response to your position

You failed to provide any additional information from which it can be concluded that your activities exclusively further or advance a purpose described in Section 501(c)(3). Although you may have some educational activities, like the organization described in Better Business Bureau, a substantial portion of your activities is providing services for a fee to co-op news organizations you help establish. Consequently the information you have provided demonstrates that you are operating for purposes that are not exclusively Section 501(c)(3) purposes.

Conclusion

Based on the information provided, you do not qualify for exemption under Section 501(c)(3) of the Code. You are not operated exclusively for one or more purposes as specified in Section 501(c)(3) and are operated for substantial nonexempt purposes.

If you don't agree

You have a right to file a protest if you don't agree with our proposed adverse determination. To do so, you must send a statement to us within 30 days of the date of this letter. The statement must include:

- Your name, address, employer identification number (EIN), and a daytime phone number
- A copy of this letter highlighting the findings you disagree with
- An explanation of why you disagree, including any supporting documents
- The law or authority, if any, you are relying on
- The signature of an officer, director, trustee, or other official who is authorized to sign for the organization, or your authorized representative

- One of the following declarations:

For an officer, director, trustee, or other official who is authorized to sign for the organization:

Under penalties of perjury, I declare that I examined this protest statement, including accompanying documents, and to the best of my knowledge and belief, the statement contains all relevant facts and such facts are true, correct, and complete.

For authorized representatives:

Under penalties of perjury, I declare that I prepared this protest statement, including accompanying documents, and to the best of my knowledge and belief, the statement contains all relevant facts and such facts are true, correct, and complete.

Your representative (attorney, certified public accountant, or other individual enrolled to practice before the IRS) must file a Form 2848, *Power of Attorney and Declaration of Representative*, with us if he or she hasn't already done so. You can find more information about representation in Publication 947, *Practice Before the IRS and Power of Attorney*.

We'll review your protest statement and decide if you provided a basis for us to reconsider our determination. If so, we'll continue to process your case considering the information you provided. If you haven't provided a basis for reconsideration, we'll forward your case to the Office of Appeals and notify you. You can find more information about the role of the Appeals Office in Publication 892, *How to Appeal an IRS Decision on Tax-Exempt Status*.

If you don't file a protest within 30 days, you can't seek a declaratory judgment in court at a later date because the law requires that you use the IRS administrative process first (Section 7428(b)(2) of the Code).

Where to send your protest

Please send your protest statement, Form 2848, if needed, and any supporting documents to the applicable address:

U.S. mail:

Internal Revenue Service
EO Determinations Quality Assurance
Room 7-008
P.O. Box 2508
Cincinnati, OH 45201

Street address for delivery service:

Internal Revenue Service
EO Determinations Quality Assurance
550 Main Street, Room 7-008
Cincinnati, OH 45202

You can also fax your statement and supporting documents to the fax number listed at the top of this letter. If you fax your statement, please contact the person listed at the top of this letter to confirm that he or she received it.

If you agree

If you agree with our proposed adverse determination, you don't need to do anything. If we don't hear from you within 30 days, we'll issue a final adverse determination letter. That letter will provide information on your income tax filing requirements.

You can find all forms and publications mentioned in this letter on our website at www.irs.gov/formspubs. If you have questions, you can contact the person listed at the top of this letter.

We sent a copy of this letter to your representative as indicated in your power of attorney.

Sincerely,

Jeffrey I. Cooper
Director, Exempt Organizations
Rulings and Agreements

Enclosure:
Publication 892

cc: